The Foreclosure Crisis in Michigan: Policy Recommendations with an Innovative Shared-Equity Proposal

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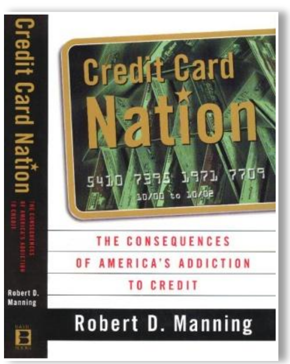
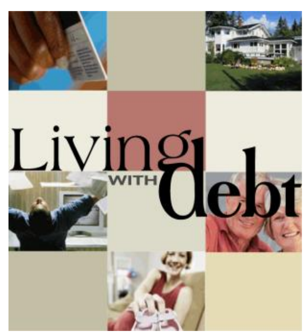
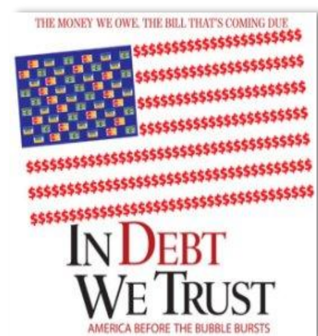






Project Goals

- Identify the major factors contributing to the rise of mortgage foreclosures.
- Investigate the economic impact of the current mortgage foreclosure crisis.
- Assess the effectiveness of current federal and state programs to reduce the number of foreclosures.
- Formulate a series of public and private sector policy recommendations to stem the flow of future foreclosures.

Contributing Factors

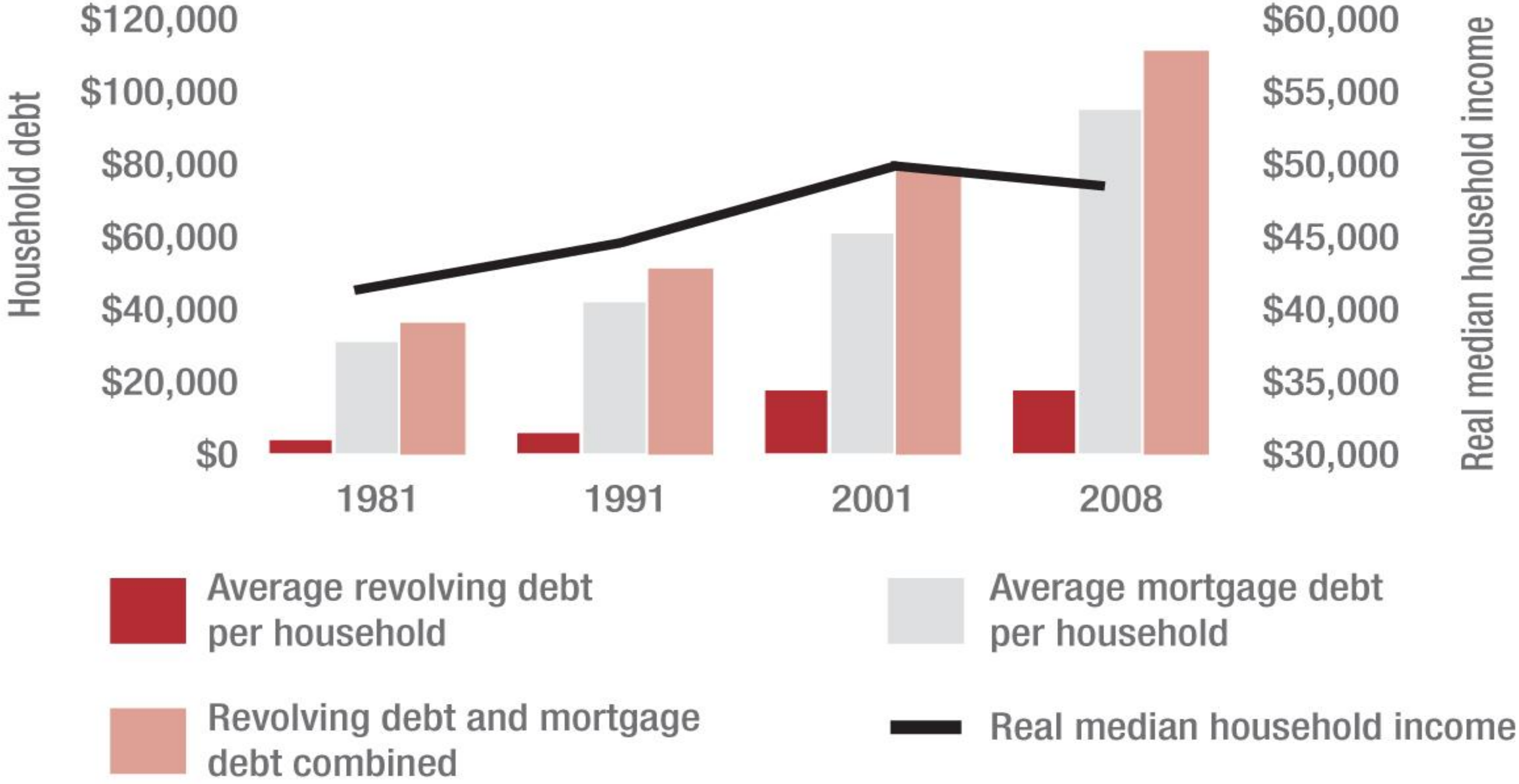
- Consumer-driven economic expansion.
- Sharp decline in loan underwriting standards.
- Popularity of consolidating consumer debt into mortgage loans.
- Rise of speculative investment in residential real estate.
- Rapid growth of mortgage and credit debt securitarization.

Consumer-Led Recession

- Unprecedented levels of household consumer debt.
- Decrease in real wages.
- Sharply reduced household wealth (housing market collapse).
- Rapid decline in personal retirement accounts.
- 2.6 million (M) jobs lost in 2008.

Contributing Factors

Average Household Debt vs. Median Household Income in Current and Past Recessions (in 2008 Dollars)



Impact of Residential Foreclosures

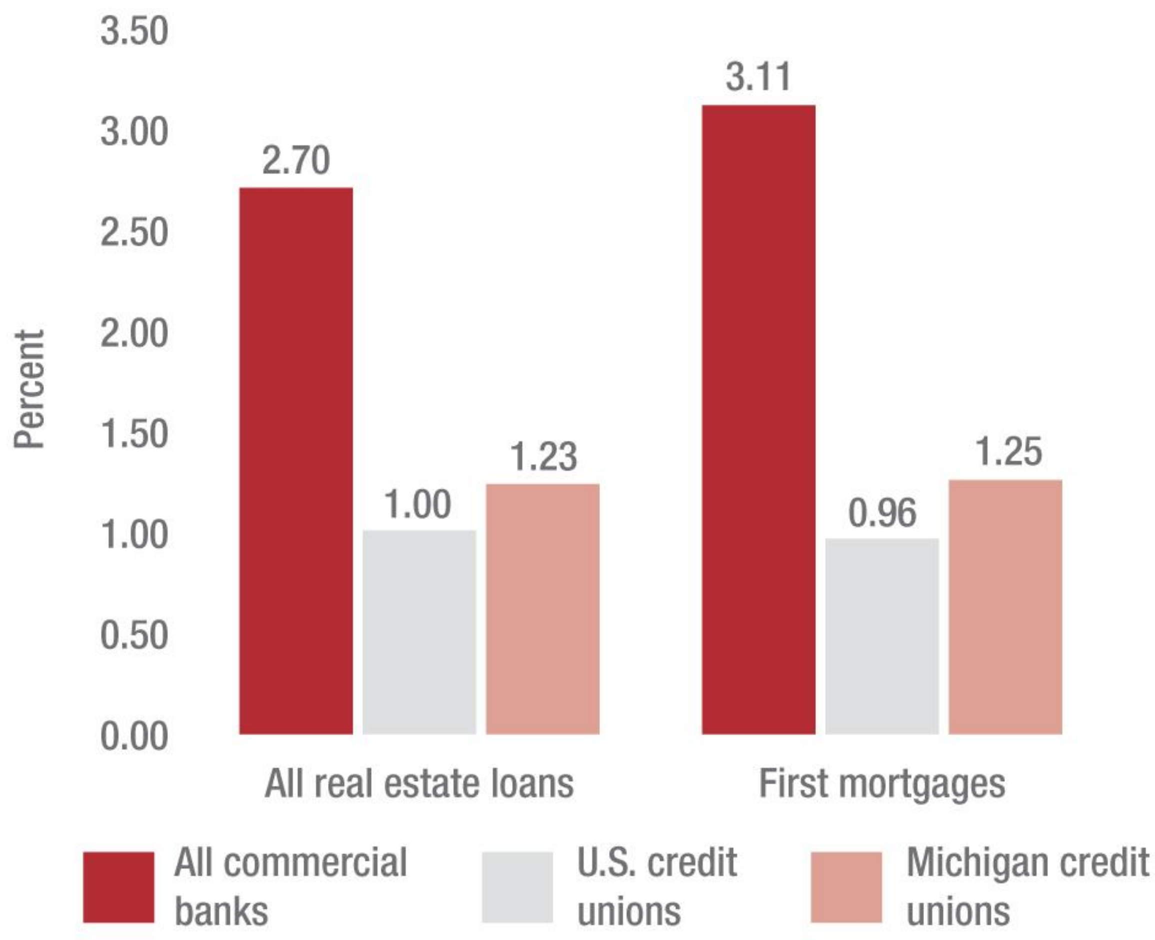
- Nationally, more than 2.3M homeowners faced foreclosure hearings in 2008.
- For financial institutions, a foreclosed property typically yields only 50–60% of the value of the original mortgage.
- Excess housing supply further depresses home values in many communities.
- Some lenders/investors refuse to take possession of homes after forcing foreclosure which accelerates neighborhood decline and financial pressure on state and local governments.

Michigan Mortgage Market

- The state of Michigan is experiencing economic distress more acutely and at a faster pace than the rest of the country.
- Michigan ranks as the nation’s 2nd highest in U.S. homeownership rate and the 4th most affordable housing market, yet it ranks 7th highest in mortgage delinquencies in the United States.
- RealtyTrac ranks Michigan as the 6th highest in the national mortgage foreclosure rate with 2.35% of all housing units in some stage of foreclosure.

Michigan Mortgage Market

Delinquency Rates on all Real Estate Loans, 60-Day (Credit Union) and 90-Day (Bank) Delinquencies (September 2008)



Current Foreclosure Interventions

An Overview and Analysis of Foreclosure Prevention Policies and Proposals

Proposal/Plan	Description	Notes
Hope for Homeowners	Lenders agree to take a loss on the loan, and the government pays off the existing mortgage and refinances into FHA loan.	Part of the July housing stimulus bill. Effective from Oct. 1, 2008 - Sept. 30, 2011. The government estimated that 400,000 would be helped; 357 people have signed up so far.
FHA Secure	Bush administration program was designed to allow homeowners with good credit who had fallen behind on payments to refinance into FHA loans when their loans reset to higher rates.	While officials estimated that it could help some 80,000 delinquent borrowers avoid foreclosure, HUD terminated the program effective Dec. 31, 2008. As of Dec. 18, 2008, some 4,100 delinquent borrowers had used the program since Sept. 2007.
FDIC modification plans	The government would share in losses resulting from re-defaults on modified mortgages and pay $1,000 to loan servicers for each completed modification.	Adapted from the model used to modify delinquent IndyMac loans. Federal Reserve Chairman Ben Bernanke proposed this plan in a recent speech. Spearheaded by FDIC Chair Sheila Bair.
Private sector modification plans	JPMorgan Chase, CitiMortgage, and Bank of America have each announced voluntary loan modification initiatives. Other banks have also been doing modifications.	The 14 largest national banks and thrifts modified nearly 73,000 loans in the first quarter and an additional 114,000 in the second quarter.
NCUA's CU HARP	Under CU HARP, credit unions borrow from the Central Liquidity Fund (CLF) and invest the funds in corporate credit union debt guaranteed by the National Credit Union Share Insurance Fund (NCUSIF). The objective of the CU HARP program is to provide struggling homeowners with a break on their mortgage interest rate.	As of January 2, 2009, the CLF funded $164M in advances under the CU HARP.
Save the Dream: Michigan State Housing Development Authority (MSHDA)	Much like the Hope for Homeowners national program above but focused on delinquent homeowners in Michigan.	Interviews with credit union executives and MSHDA staff indicated the program was more a "public awareness campaign" than a large-scale foreclosure remediation program.
Proactive forbearances by credit unions	Credit unions interviewed for this research project identified actions taken with individual borrowers to prevent foreclosure without public assistance.	Not scaleable. Success rate is uncertain based on the small number of interviews we conducted.
Various state initiatives	States across the United States are implementing a variety of foreclosure prevention policies; some examples include: North Carolina House Bill 2623 and California State Bill 1137.	Too early to determine effectiveness of programs, but foreclosure delay programs seem to be ineffective while coordinated state-level work with mortgage services is more effective.
Helping Families Save Their Homes in Bankruptcy Act of 2009*	Bill proposes giving bankruptcy judges the power to reduce the interest rates and principal amounts of home loans—known as a "cram down" provision.	Introduced earlier this year by Rep. John Conyers Jr., supporters include the National Association of Home Builders and Citigroup. Still, many lenders oppose this bill.
Government shares modification costs*	Government shares the cost when the borrower's monthly payment is reduced.	Also proposed by Bernanke, this plan would require the government to incur costs in all modifications not just in re-defaults.
Government purchases delinquent mortgages*	Government buys delinquent mortgages in bulk and refinances them into FHA mortgages.	Another Bernanke proposal. It could take more time to implement but has potential to reach more borrowers than the other programs.

Current Foreclosure Interventions

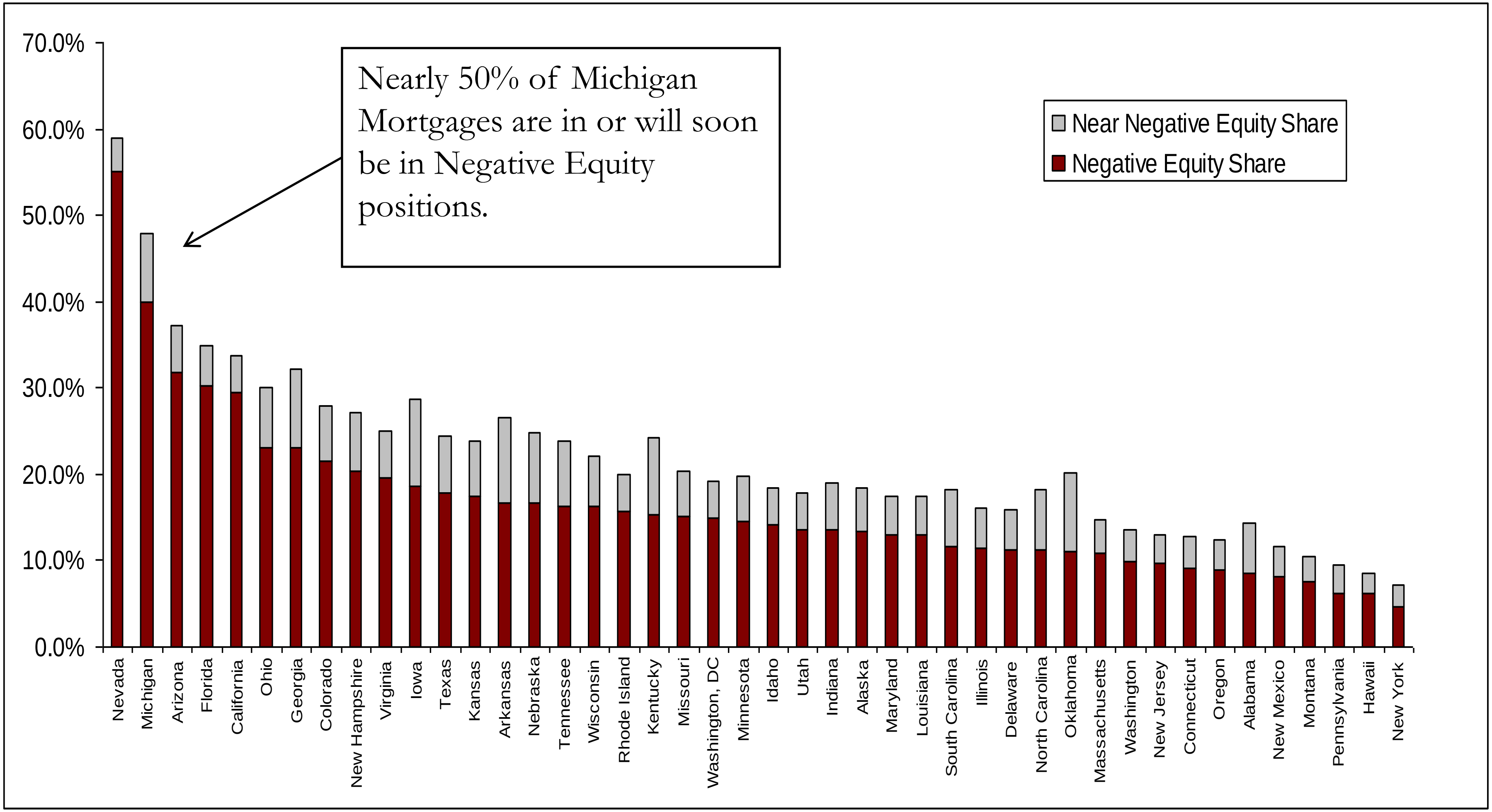
- *"If you're looking at a way to get to the bottom of the economic problems in our country, it is the housing foreclosure problem. We've got to address that."*

  ---Senator Christopher Dodd, Chairman,

  U.S. Senate Banking Committee

- Limited effect of home mortgage intervention programs introduced in 2008.
- Many mortgage modifications made in 2008 simply consolidated payment arrears and will require future loan adjustments.

Negative Equity Rates by State



Source: Author's calculations and First American CoreLogic
Near Negative Equity is 95% -100% Loan to Value mortgages.

Michigan vs. National Alt-A Mortgages

	Michigan	National
Number of Alt-A Mortgages	52,073	2,139,150
Average interest rate	6.41%	6.29%
Average balance	$185,138	$321,094
Average loan age (months)	40	37
Average FICO	702	705
Average combined LTV at origination	85.51	81.15
Number with interest only	15,909	586,293
Number with Negative Amortization	5,982	358,168

% with 30-59 days past due	6.1%	5.6%
% with 60-89 days past due	2.9%	3.4%
% with 90+ days past due	5.4%	7.4%
% in foreclosure	3.4%	7.7%
% originated in 2007	13.6%	21.6%
% originated in 2006	29.9%	35.7%
% originated in or before 2005	56.5%	42.7%
% with no or low documentation	53.9%	73.0%

% ARM loans	44.6%	52.4%
Average initial interest rate	4.93	4.49
Average current interest rate	6.10	6.01
% resetting in next 12 months	8.5%	6.1%
% resetting in 12-23 months	14.0%	9.6%

Source: Federal Reserve Bank of New York, available at http://www.newyorkfed.org/regional/subprime.html

Michigan vs. National Subprime Mortgages

	Michigan	National
Number of Subprime Mortgages	113,140	2,650,083
Average interest rate	8.73%	8.26%
Average balance	$120,814	$181,741
Average loan age (months)	45	42
Average FICO	604	617
Average combined LTV at origination	86.72	84.32
Number with interest only	7,202	285,275
Number with Negative Amortization	14	750
% with 30-59 days past due	11.5%	10.5%
% with 60-89 days past due	6.7%	6.0%
% with 90+ days past due	15.3%	13.6%
% in foreclosure	5.5%	11.8%
% originated in 2007	10.5%	15.1%
% originated in 2006	31.4%	36.4%
% originated in or before 2005	58.1%	48.6%
% with no or low documentation	25.7%	32.3%
% ARM loans	71.5%	60.7%
Average initial interest rate	8.37	8.04
Average current interest rate	8.95	8.57
% resetting in next 12 months	9.7%	13.7%
% resetting in 12-23 months	1.8%	3.0%

Source: Federal Reserve Bank of New York, available at http://www.newyorkfed.org/regional/subprime.html

Total Mortgage Portfolio Performance: 2008 Quarterly Data

Total Mortgage Portfolio (Percent of All Mortgage Loans in the Portfolio)				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Current and Performing	93.33%	92.61%	91.48%	89.95%
30-59 Days Delinquent	2.59%	2.85%	3.20%	3.44%
The Following Three Categories Are Classified as Seriously Delinquent.				
60-89 Days Delinquent	0.97%	1.06%	1.29%	1.56%
90 or More Days Delinquent	1.34%	1.37%	1.70%	2.45%
Bankruptcy 30 or More Days Delinquent	0.35%	0.51%	0.56%	0.60%
Subtotal for Seriously Delinquent	**2.66%**	**2.94%**	**3.54%**	**4.60%**
Foreclosures in Process	1.41%	1.59%	1.78%	2.00%
Total Mortgage Portfolio (Number of Mortgage Loans in the Portfolio)				
Current and Performing	32,303,802	32,182,548	31,689,516	31,210,743
30-59 Days Delinquent	896,636	990,347	1,108,701	1,194,136
The Following Three Categories Are Classified as Seriously Delinquent.				
60-89 Days Delinquent	335,517	368,527	446,339	540,263
90 or More Days Delinquent	463,369	477,256	588,399	850,343
Bankruptcy 30 or More Days Delinquent	122,053	176,849	192,929	207,077
Subtotal for Seriously Delinquent	**920,939**	**1,022,632**	**1,227,667**	**1,597,683**
Foreclosures in Process	489,317	553,480	614,881	694,056

OCC and OTS Mortgage Metrics Report – Disclosure of National Bank and Federal Thrift Mortgage Loan Data. Fourth Quarter 2008. April 2009: Washington, D.C., available at http://files.ots.treas.gov/4820362.pdf

Delinquent Mortgages By Loan Type

Seriously Delinquent (Percent of All Mortgage Loans in Each Category)				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Prime	1.11%	1.30%	1.67%	2.40%
Alt-A	5.18%	5.80%	7.05%	9.10%
Subprime	10.75%	11.60%	13.52%	16.40%
Other	2.88%	3.10%	3.57%	4.42%
Overall	2.66%	2.94%	3.54%	4.60%
Seriously Delinquent (Number of Loans in the Portfolio)				
Prime	251,091	301,069	384,781	553,736
Alt-A	185,050	208,770	252,319	325,462
Subprime	334,251	359,314	414,498	498,154
Other	150,547	153,479	176,069	220,331
Total	920,939	1,022,632	1,227,667	1,597,683

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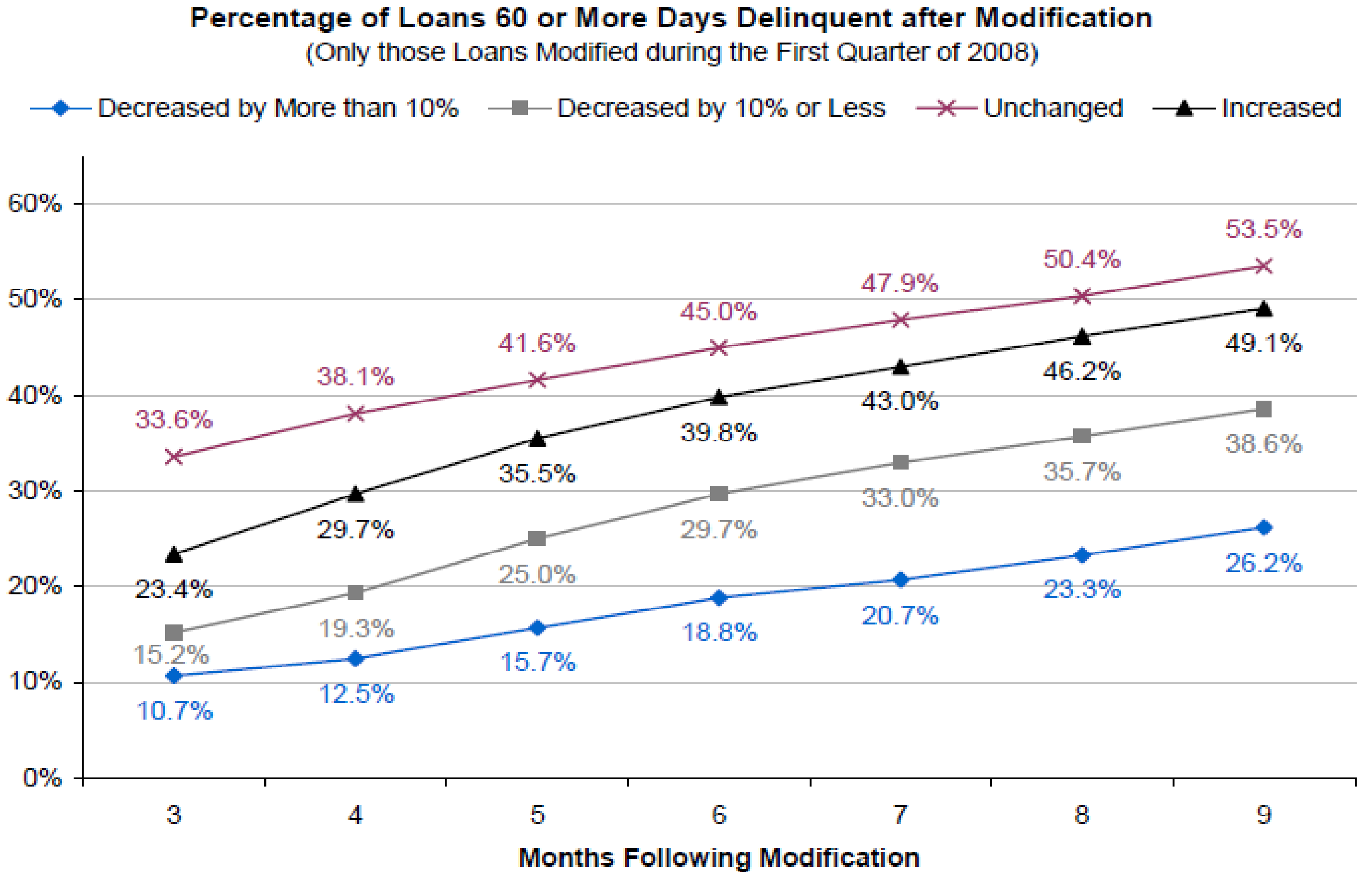
Mortgage Modifications in 2008

Changes in Monthly Payments for Loans Modified in 2008		
	Percent of All Modifications	Number of Modifications in Each Category
Decreased by More Than 10%	29.31%	124,008
Decreased by 10% or Less	12.54%	53,083
Unchanged	26.58%	112,476
Increased	31.57%	133,585
Total	100.00%	423,152

OCC and OTS Mortgage Metrics Report – Disclosure of National Bank and Federal Thrift Mortgage Loan Data. Fourth Quarter 2008. April 2009: Washington, D.C., available at http://files.ots.treas.gov/4820362.pdf

Re-default Rates on Mortgage Modifications in 1st quarter of 2008



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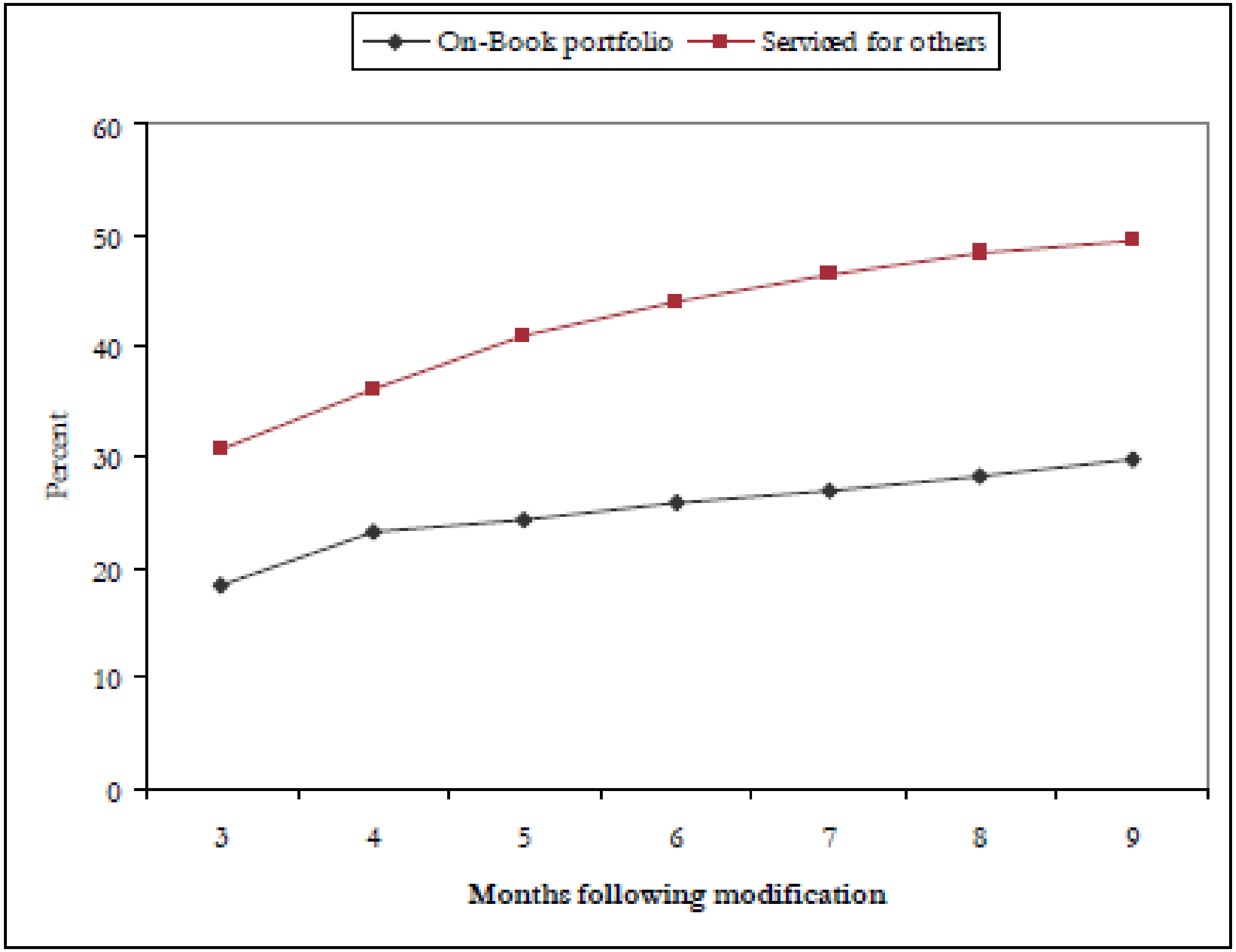
Percentage of Loans 60 or More Days Delinquent after Modification



Source: OCC and OTS Mortgage Metrics Report – Disclosure of National Bank and Federal Thrift Mortgage Loan Data. Fourth Quarter 2008, April 2009

Policy Proposals

- Proposal #1: Reform and Streamline the Home Foreclosure Process as Supervised by Federal Regulators.

- Proposal #2: Implement <u>Limited</u> Discretionary Authority for Federal Bankruptcy Courts to Modify Most Problematic Mortgage Loans.

Policy Proposals

- Proposal #3: Use Chapter 7 Bankruptcy as a Strategy to Retain Principal Residences.

- *Proposal #4: Utilize and Standardize Shared-Equity Agreements as an Incentive to Encourage Loan Modifications.*

Policy Proposals

- Proposal #5: Establish Lender Accountability for Consumer Requests for Mortgage Modifications.
- Proposal #6: Establish a Database of Mortgage Borrowers that Received Loan Concessions.

Policy Proposals

- Proposal #7: Establish a Federal Hotline for Locating Investors of Asset-Backed Securities and CDOs.

- Proposal #8: Create State and Local “Working Groups” for Home Ownership Assistance.

Policy Proposals

- Proposal #9: Establish Responsible Debt Relief (RDR) Programs.

- Proposal #10: Convene State and Local Debt Summits.

Summary of Policy Proposals

Proposal	Issue addressed	Mortgage segment	Type
Reform and streamline the home foreclosure process as supervised by federal regulators	Foreclosure process	2 & 4	Legislative
Implement limited discretionary authority for federal bankruptcy courts to modify most problematic mortgage loans	Bankruptcy	2 & 4	Legislative
Use Chapter 7 bankruptcy as strategy to retain principal residences	Bankruptcy	2 & 4	Private and public sector initiative
Utilize and standardize shared-equity agreements as an incentive to encourage loan modifications	Loan modification	2, 3, & 4	Private and public sector initiative
Establish lender accountability to consumer requests for mortgage modifications	Loan modification	2, 3, & 4	Legislative
Establish a database of mortgage borrowers that received loan concessions	Loan modification	2, 3, & 4	Legislative
Establish federal hotline for locating investors of asset-based securities and CDOs	Loan modification	3 & 4	Private and public sector initiative
Create state and local "working groups" for home ownership assistance	Counseling	2 & 4	Private and public sector initiative
Establish responsible debt relief (RDR) programs	Counseling	2 & 4	Private and public sector initiative
Convene state and local debt summits	Counseling	2 & 4	Private and public sector initiative

Mortgage Segment 1=Prime Mortgage Loans Held by Depository Institutions
Mortgage Segment 2=Subprime Mortgage Loans Held by Depository Institutions
Mortgage Segment 3=Prime Mortgages Pooled with Servicers
Mortgage Segment 4=Subprime Mortgages Pooled with Servicers

Proposal #4: Utilize and Standardize Shared-Equity Agreements as an Incentive to Encourage Loan Modifications.

- Development of “shared-equity” forbearance agreements between loan holders and mortgagees would limit the financial losses arising from voluntary mortgage modifications.
- Lenders would share in the capital gains arising from the future sale of the principal residence up to a limit of the debt forbearance.
- Special attention would be paid to establishing proper incentives for lenders to participate in these loan modification programs, and standardizing such programs across all lending and servicing institutions.

Shared Equity Agreement: Example

- Home Value: declines from $150,000 to $120,000
- Lender: Exposed to $30,000 loss plus maintenance and transactions costs following a foreclosure or short-sale
- Shared equity agreement Proposal
  - Refinance home with a first mortgage at current home value ($120,000 in this example)
  - A second mortgage/forbearance of 20% of debt concession ($6,000 in this example, 0.2*30,000)
  - Remaining concession would be negotiated as a Shared Equity Agreement ($30,000 in this example)
  - *Terms would be contingent on length of time of homeownership after the principal reduction.*

Shared Equity Agreement:

- *Same example: Mortgage principal reduction from $150,000 to $120,000 in 2009.*
- *Lender offers principal reduction of $30,000 with Shared-Equity Agreement (including a* second mortgage/forbearance of 20% of debt concession)
- *What happens with the following scenarios: homeowner sells the home after 5, 10, and 20 years.*

Sale of Home	5 years later (2014)	10 years later (2019)	20 years later (2029)
Sale Price	$130,000	$165,000	$250,000
Net Proceeds	$120,000	$150,000	$235,000
Balance of 1st Mortgage	$113,000	$98,000	$56,000
Forbearance Amount	$6,000	$6,000	$6,000 plus %
Shared-Equity	$1,000	$46,000	$173,000
Shared-Equity split	$500	$23,000	$24,000
Principal FORGIVEN	**$23,500**	**$1,000**	**$0**
Homeowner Share	$500	$23,000	$149,000

Shared Equity Agreement:
HELOCs and 2nd Mortgages

- A HELOC or other second mortgage on the original, pre-modified mortgage could be offered a10% forbearance that is subordinate to the first mortgage forbearance.
- Although technically worthless if the borrower had negative equity in the home, the lender of the second mortgage could obstruct the refinance unless offered a financial premium to waive its financial claim.
- After the 10% second mortgage forbearance is repaid, it would receive a maximum of 20% more in a 70%/30% split with the homeowner after the concession of the first mortgage is repaid.

LOOK AT MY PIGGY BANK!
LOOKS LIKE MY 401K ACCOUNT

Q & A